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BELLSOUTH

Kathleen B. Levitz
Vice President-Federal Regulatory

Suite 900
1133-21st Street, N.W.
Washington, D.C. 20036-3351
202 463-4113
Fax: 202 463-4198
Internet: levitz.kathleen@bsc.bls.com

EX PARTE OR LATE FILED

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WRITTEN EX PARTE

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
The Portals
445 12th Street, S.W., Room TW-A325
Washington, D.C. 20554

Re: CC Docket No. 96-98

Dear Ms. Salas:

On March 19, 1999, AT&T filed its analysis of the application of forward-looking cost principles in several states, including several served by BellSouth. Attached is BellSouth's response in which BellSouth clarifies what actually transpired in the state proceedings discussed in the AT&T filing.

In accordance with Section 1.1206(b)(1), I am filing two copies of this notice in the docket identified above. If you have any questions concerning this, please call me.

Sincerely,

Kathleen B. Levitz

Kathleen B. Levitz

cc: Christopher Wright
Katherine Brown
Larry Strickling
Tom Power
Linda Kinney
Kyle Dixon
Kevin Martin
Sarah Whitesell

BellSouth Corporation ("BellSouth") respectfully submits the following response to the *ex parte* filed by AT&T Corporation ("AT&T") on March 19, 1999, which included an "analysis of the application forward-looking cost principles" by selected state commissions. While claiming that "few generalizations can be made about the rates adopted in state arbitration and rate proceedings," *ex parte* at 3, AT&T's "analysis" is replete with sweeping generalizations as well as gross distortions of what actually has transpired in rate proceedings in BellSouth's states. BellSouth submits this response to set the record straight and to respond to AT&T's request that the Commission promulgate new pricing rules in light of state commission decisions with which AT&T disagrees.

As a preliminary matter, the Commission should view with considerable skepticism AT&T's complaints about the cost-based rates established by state commissions in BellSouth's region. Although not disclosed by AT&T, all eight state commissions in BellSouth's region that have established permanent cost-based rates to date have done so using BellSouth's forward-looking cost studies.[1] Given that not one of these eight state commissions set rates for

[1] *See* Order, *In re Generic Proceedings: Consideration of TELRIC Studies,* Docket No. 26029, at 20 (Ala. Pub. Serv. Comm'n August 25, 1998); Order No. PSC-96-1579-FOF-TP, *In re Petition by Metropolitan Fiber Systems of Florida, Inc., et al.*, Docket No. 960757-TP, at 33 (Fla. Pub. Serv. Comm'n Dec. 31, 1996); Order Establishing Cost-Based Rates, *In re: Review of Cost Studies, Methodologies, and Cost-Based Rates for Interconnection and Unbundling of BellSouth Telecommunications Services,* Docket No. 7061-U, at 16 (Ga. Pub. Serv. Comm'n Dec. 16, 1997); Order, *In re: Interconnection Agreement Between AT&T Communications of the South Central States, Inc. and BellSouth Telecommunications, Inc.*, Case No. 96-482, at 2 (Ky. Pub. Serv. Comm'n July 14, 1997); Order No. U-22022/22093-A, *In re: Review and Consideration of BellSouth's TSLRIC and LRIC Cost Studies*, Docket No. U-22022/22093, at 4 (La. Pub. Serv. Comm'n Oct. 24, 1997); Order, *In re: Generic Proceeding to Establish "Permanent" Prices for BellSouth Interconnection and Unbundled Network Elements,* Docket No. 97-AD-544, at 4 (Miss. Pub. Serv. Comm'n Aug. 25, 1998); Order, *In re: General Proceeding to Determine Permanent Pricing for Unbundled Network Elements,* Docket No. P-100, Sub 133d, at 26 (N.C. Utilities Comm'n Dec. 10, 1998) (finding it "more reasonable" to modify BellSouth's studies "than to discard those studies in favor of the models presented by AT&T and MCI and then attempt to adjust those models to make them suitable to North Carolina"), *petitions for reconsideration pending*; Order No. 98-214, *In re: Proceeding to Review BellSouth's Telecommunications, Inc.'s Cost Studies for Unbundled Network Elements,* Docket 97-374-C, at 21 (S.C. Pub. Serv. Comm'n June 1, 1998).

unbundled network elements based upon the Hatfield (or HAI) Model sponsored by AT&T,[2] AT&T's complaints about alleged "departures from forward-looking methodologies" should properly be classified as a case of "sour grapes."

There is no merit to AT&T's argument that the BellSouth cost studies used to establish cost-based rates are not "forward-looking" but are actually "backward engineered to support existing embedded rates." *Ex parte* at 6. This argument is impossible to reconcile with two recent federal court decisions affirming the Kentucky Public Service Commission's decision to establish rates based upon BellSouth's cost studies. *See AT&T Communications of the South Central States, Inc. v. BellSouth Telecommunications, Inc.*, 20 F. Supp. 2d 1097, 1102 (E.D. Ky. 1998) (holding that the Kentucky Commission's conclusion "that BellSouth's studies more closely reflected actual total element long-run incremental cost ("TELRIC") studies than did AT&T's vigorously espoused Hatfield model justified its adoption of the studies as the primary basis for its eventual pricing decision"). In *MCI Corp. v. BellSouth Telecommunications, Inc.*, 1999 U.S. Dist. LEXIS 2775 (E.D. Ky. March 11, 1999), the same federal court rejected MCI's argument, which is the identical argument AT&T makes in its *ex parte*, that BellSouth's cost studies "are based on BellSouth's existing network configuration and embedded technology" and therefore inconsistent with this Commission's methodology. *Id.* at *11. Holding that rates "based on BellSouth's cost studies in comparison with those presented by MCI, are indeed

[2] *See, e.g.,* Alabama Commission Order, Docket No 26029, at 18-19 (noting "Hatfield's weaknesses," including the assumption that CBGs are square and the failure to consider "geographical constraints such as nature and man-made barriers, depressions, elevations, and bodies of water"); Florida Commission Order No. PSC-96-1579-FOF-TP, at 29 (concluding that "the Hatfield Model understates costs"); Georgia Commission Order Establishing Cost-Based Rates, Docket No. 7061-U (concluding that "[t]he Hatfield Model, by contrast with BellSouth's approach, ignores that BellSouth's network typically grows in discrete increments to meet demand growth as it materializes"); South Carolina Commission Order No. 98-214, at 26 ("The Hatfield Model makes assumptions that completely disregard BellSouth's service area in South Carolina").

forward-looking and comply with the 1996 Act," the court refused to disturb the rates established by the Kentucky Commission. *Id.*

Claiming that the Florida Public Service Commission "determined that network elements should reflect 'existing technology' ... [and] physical architecture deployed by 'BellSouth,'" AT&T is particularly critical of the Florida Commission. *Ex parte* at 4. AT&T seriously distorts the Florida Commission's ruling by taking the cited quotation completely out of context. What the Florida Commission actually held was:

> It should be noted that the methodology the FCC uses to define TELRIC would not necessarily be used by this Commission in determining the TSLRIC cost. For example, the FCC's TELRIC definition uses a scorched node approach. We have used a TSLRIC approach using efficient technology in our proceedings conducted pursuant to Chapter 364, Florida Statutes. The difference between these methodologies is that the scorched node approach only considers the current location of central offices, and not the existing technology or physical architecture deployed by the carrier in either the central office or outside plant. The TSLRIC based forward-looking approach considers the current architecture and the future replacement technology. Upon consideration, we do not believe that there is a substantial difference between the TSLRIC cost of the network element and the TELRIC of a network element.

Florida Commission Order No. PSC-96-1579-FOF-TP, at 23-24. Accordingly, AT&T's claim that the Florida Commission "significantly departed from forward-looking methodologies" cannot be reconciled with the facts.[3]

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[3] AT&T also criticizes the Florida Commission for establishing rates for certain unbundled network elements in 1996 based upon BellSouth's tariffed rates. *Ex parte* at 6. AT&T neglects to mention that the Florida Commission only used tariffed rates on an interim basis for a limited number of elements for which BellSouth had not filed forward-looking cost studies. *See* Order No. PSC-96-1579-FOF-TP, at 33 (noting that "in those instances where BellSouth did not provide a TSLRIC study, we find it appropriate to set interim rates based on the Hatfield study results with modifications or BellSouth's tariff"). The Commission has endorsed using tarrifed rates on an interim basis. *See* 47 CFR § 51.513 (c)(6) (allowing state commission to establish proxy rates for collocation that are "no greater than the effective rates for equivalent services in the interstate expanded interconnection tariff"). AT&T also neglects to mention that the Florida Commission has since conducted proceedings to establish "permanent rates" to replace the interim rates based upon BellSouth's tariff, which renders AT&T's complaint moot. *See* Order No. PSC-98-0604-FOF-TP, at 10 (establishing permanent prices "on those elements for which we had established interim rates ...").

Although the state commissions in BellSouth's region have adopted permanent rates based upon forward-looking costs, AT&T erroneously argues that their decisions should have strictly adhered to all of the Commission's pricing rules, including the implementation of geographically deaveraged rates. *Ex parte* at 11. This argument ignores that the Commission's pricing rules were not in effect at the time these state commissions rendered their pricing decisions by virtue of the orders of the Eighth Circuit Court of Appeals staying and then vacating those rules.

In *MCI Telecommunications Corp. v. GTE Northwest, Inc.*, 1999 U.S. Dist. LEXIS 3129 (D. Oregon March 17, 1999), MCI asserted that certain provisions in MCI's interconnection agreement with GTE should be overturned because they were inconsistent with the Commission's pricing rules. The court rejected this argument, holding that the Oregon Public Utility Commission had not erred in failing to apply substantive regulations that were not in effect when the agreement was approved, notwithstanding the Supreme Court's subsequent decision upholding the Commission's authority to promulgate such rules. *Id.* at *7. As the court observed, there is "a crucial distinction between applying a new interpretation of law that admittedly was in effect during the relevant time period, versus applying a substantive regulation that never was in effect to begin with." *Id.* Accordingly, AT&T's attempt to apply rules that were not in effect when the state commissions in BellSouth's region rendered their permanent pricing decisions is misguided.

In an attempt to buttress its complaints about the cost-based rates established by state commissions in BellSouth's region, AT&T compares "the UNE platform rates for several illustrative states" with "the corresponding FCC proxy rate" and "the HAI Model rate for that state." *Ex parte* at 14. This comparison is misleading. First, notwithstanding AT&T's

suggestion to the contrary, the BellSouth states referenced in AT&T's filing did not establish rates for the so-called "UNE platform." For example, in Louisiana, even though the Louisiana Commission's consultant developed costs under two scenarios – a platform scenario and a stand-alone (i.e., unbundled) scenario – the Louisiana Commission adopted the "stand alone" cost in establishing rates for unbundled network elements. *See* Order No. U-22022/22093-A, *In re Review and Consideration of BellSouth's TSLRIC and LRIC Cost Studies*, Docket No. U-22022/22093, at 5 (La. Pub. Serv. Comm'n Oct. 24, 1997). Thus, it is not readily apparent how AT&T has calculated an "Ordered Platform Rate" for states that did not order such a rate.

Second, using the Hatfield model as a point of comparison erroneously assumes that the model represents an acceptable method for developing the cost of unbundled network elements, which, as eight state commissions and one federal court in BellSouth's region have concluded, is not the case. *See MCI Telecommunications Corp v. BellSouth Telecommunications, Inc.* 1999 U.S. Dist. LEXIS 2775, *11, n.4 (noting that "[m]any PSCs in other states have held that the Hatfield model is unreliable and suffers from design flaws"). This Commission has previously expressed similar concerns and has declined to embrace the Hatfield methodology. *See, e.g.,* First Report and Order, *In re: Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket 96-98, ¶ 794 (Aug. 8, 1996) (noting that the Hatfield model outputs do not "necessarily represent accurate estimates of the absolute magnitude of the loop cost"); Fifth Report and Order, *In re: Federal-State Joint Board on Universal Service*, CC Docket 96-45, ¶ 57 (Oct. 28, 1998) (Hatfield model's approach of designing plant "could result in a systematic underestimation of outside plant cost").[4]

[4] AT&T's claim that "the FCC recently incorporated large portions of the HAI model into it [sic] its universal cost mechanism" is irrelevant. *Ex parte* at 13. In developing its universal service cost platform, the FCC completely rejected the HAI Model for determining outside plant design, a significant component of which is the local loop. Since loop costs are, as AT&T admits, "the largest network element cost," *ex parte* at 11, the

Third, comparing permanent cost based rates established by state commissions in BellSouth's region with the Commission's proxy rates adopted almost three years ago proves nothing. The Commission's proxy rates were adopted for use by a state commission only if that state commission determines "that the cost information available to it with respect to one or more elements does not support the adoption of a rate or rates that are consistent with requirements set forth in" the Commission's pricing rules. 47 C.F.R. § 51.513(a). The Commission's rules do not require, let alone contemplate, that the proxy rates would serve as a benchmark by which permanent cost based rates must be judged.[5]

AT&T's complaints about levels of non-recurring charges and OSS cost recovery are meritless. *Ex parte* at 15. For example, while claiming that the Louisiana Public Service Commission approved non-recurring rates which it found to be "excessive," *ex parte* at 17, the order cited by AT&T in support of this claim is not an order of the Louisiana Commission, but rather is an order of the Florida Public Service Commission. Furthermore, the non-recurring charges established by the Florida Commission about which AT&T complains were only approved on an interim basis. AT&T conveniently neglects to mention that the Florida Commission subsequently completed further proceedings to establish permanent cost-based non-recurring rates to replace the interim rates at issue. *See* Order No. PSC-98-0604-FOF-TP (Fla.

Commission's decision not to rely upon the outside plant design of the HAI Model in determining the cost of universal service is fatal to AT&T's view that state commissions should have used the model to develop the cost of unbundled network elements.

[5] BellSouth and other incumbents have alleged that the Commission's proxy prices are contrary to the Act and otherwise arbitrary and capricious. *See generally* Brief for Petitioners Regional Bell Companies and GTE, Case No. 96-3321 at 37-40 (filed Nov. 18, 1996). As is the case with the Commission's other pricing rules, the Eighth Circuit Court of Appeals has yet to rule on these substantive issues. The Eighth Circuit also has yet to rule on a motion by several incumbents requesting that the Eighth Circuit not alter its mandate vacating the Commission's default proxy rules, given the Commission's acknowledgement before the Supreme Court that these "temporary and optional 'default proxies' ... were designed for a past period in which no cost studies could have been made available to the state commissions" and thus "have no [current] relevance to this case." Motion of the Local Exchange Carriers Regarding Further Proceedings on Remand, at 6-7 (quoting Respondents' Reply Brief at 7, n. 15, Case No. 97-826 (U.S. June 17, 1998)).

Pub. Serv. Comm'n) (establishing permanent prices "on those elements for which we had established interim rates ...").

AT&T also fails to mention that a federal court has considered and rejected AT&T's position that competing local carriers should not be required to pay for the cost of OSS development. In *AT&T Communications of the South Central States, Inc. v. BellSouth Telecommunications, Inc.*, 20 F. Supp. 2d 1097 (E.D. Ky. 1998), the court upheld the provision in AT&T's interconnection agreement with BellSouth in Kentucky (which is the same provision cited in AT&T's *ex parte*), which provides that "[a]ll costs incurred by BellSouth to implement operation interfaces shall be recovered from the [new entrants] on a fairly apportioned basis." *Id.* at 1104. The court held that this provision was not discriminatory, even though it imposed costs on competing carriers that are not imposed on BellSouth. According to the court,

> Because the electronic interfaces will only benefit the CLECs, the ILECs, like BellSouth, should not have to subsidize them. BellSouth has satisfied the nondiscrimination prong by providing access to network elements equivalent to the access provided for itself. AT&T is the cost causer, and it should be the one bearing all the costs; there is absolutely nothing discriminatory about this concept.

Id..[6]

Although it takes AT&T more than 20 pages of "analysis" before coming right out and saying so, AT&T is really asking the Commission to adopt new rules which, according to AT&T, would "explain, clarify and elaborate upon its forward-looking pricing rules." *Ex parte* at 21-22. At the very least, this request is premature. While the Supreme Court has upheld the Commission's jurisdiction to promulgate its pricing rules, numerous parties originally challenged

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[6] The Kentucky court's decision is completely consistent with "the general principle, long recognized by the Commission, that the cost-causer should pay for the cost that he or she incurs." First Report and Order and Further Notice of Proposed Rulemaking, *In re: Telephone Number Portability,* CC Docket No. 95-116, ¶ 131 (July 2, 1996). Unlike with the cost of number portability which Congress directed be borne by all telecommunications carriers on a competitively neutral basis, there is no "statutory mandate" that would create an exception to the

these rules, not only on jurisdictional grounds but also on the ground that they violate the law as a substantive matter. The Eighth Circuit did not reach the merits of these rules in its original decision, *Iowa Utilities Board v. FCC*, 120 F.3d 753, 800, 806, n.26 (8th Cir. 1997), and the Supreme Court acknowledged that the merits of these rules were not before it. *AT&T Corp. v. Iowa Utilities Board*, __ U.S. __, 119 S. Ct. 721, 727, n.3 (Jan. 25, 1999). Thus, the Eighth Circuit must now resolve the substantive challenges to the Commission's rules. Until it does so, no useful purpose would be served in promulgating new regulations "explaining, clarifying, and elaborating" upon rules that may not withstand judicial scrutiny.

Even if it were inclined to promulgate additional pricing regulations, the Commission should preserve state commissions' abilities to exercise independent judgment in establishing rates for unbundled network elements. While AT&T suggests that "differences in factual circumstances (*e.g.*, population density)" cannot explain pricing variations from state to state, *ex parte* at 20, there are other factors at work that readily explain such variations, which AT&T apparently seeks to eliminate. We discuss some of those factors in the following paragraph.

In establishing rates, state commissions in BellSouth's region generally had to choose between BellSouth's cost studies and different iterations of the Hatfield model. These state commissions had to establish loop rates, for example, based upon either BellSouth's forward-looking cost studies which take into account existing roads, rights-of-way and pole lines, or the Hatfield Model which uses a network design methodology that even this Commission has declined to embrace. These state commissions also had to consider that BellSouth's cost studies could be used to establish rates for hundreds of unbundled network elements, while the Hatfield Model develops costs for only a limited number of elements. Even after selecting a cost model,

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principle that competing carriers, as the parties that caused the costs of OSS development to be incurred, should pay those costs.

the state commissions still had to make difficult decisions concerning forward-looking inputs, including, but not limited to, fill factors, structure sharing, network design, and cost of capital assumptions. The state commissions had to make these decisions in the exercise of their reasoned judgment based upon all the evidence in the administrative record and their unique knowledge of the circumstances in their respective state. As the Commission well knows, establishing rates involves a balancing process that state commissions are uniquely qualified to perform.

Although AT&T is apparently dissatisfied with most of the results it has obtained in state rate proceedings to date, such dissatisfaction hardly warrants the promulgation of new pricing rules that, if AT&T had its way, would strip state commissions of any meaningful role in the establishment of prices for unbundled network elements. To the extent AT&T believes that any state commission has established cost-based rates in violation of the Telecommunications Act of 1996, AT&T's remedy is to challenge those rates in federal court (which AT&T has done in a number of BellSouth's states, including Kentucky, Georgia, Florida, and Louisiana). Because the only reported federal court decision to date in BellSouth's region rejected AT&T's challenges, s*ee AT&T Communications of the South Central States, Inc. v. BellSouth Telecommunications, Inc.*, 20 F. Supp. 1097 (E.D. Ky. 1998), AT&T's complaints about cost-based rates and its desire for new pricing rules should be taken with the proverbial "grain of salt."

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